A. GTE-I Will Be Transferred to a Separate Corporation ("DataCo") That Will Be 90% Owned and Controlled By Public Shareholders Pending InterLATA Relief.

Bell Atlantic/GTE will eliminate the section 271 issue that would arise from Bell Atlantic's ownership of GTE Internetworking through the following structure:

GTE will transfer substantially all of GTE-I's existing nationwide data business into a corporation ("DataCo") that will be publicly owned and controlled. Through an initial public offering, or "IPO," public shareholders will purchase shares of DataCo Class A common stock, which will initially carry 90% of the voting rights and the right to receive 90% of any dividends or other distributions. In exchange for the transfer of GTE-I, the merged Bell Atlantic/GTE will receive shares of Class B stock of DataCo that will have 10% of the voting rights and the right to receive 10% of any dividends or other distributions. Bell Atlantic/GTE will also have the option in the form of conversion rights to increase its ownership in the future once it receives sufficient interLATA relief to operate the business. The Class B shares will be convertible into shares that will represent 80% of the outstanding shares following conversion, assuming no additional shares are issued in the interim. That percentage will be reduced when DataCo issues additional shares.

The Bell Atlantic/GTE merger would close as soon as all Class A shares have been irrevocably transferred to one or more investment banks for purposes of conducting the IPO. Depending on the status of the IPO documents filed with the Securities and Exchange Commission and the conditions in the securities markets, the IPO either will be carried out immediately upon transfer or the shares will be transferred to a consortium of at least three banks for sale to the public at a later date. The consortium of banks, acting at the direction of DataCo's independent board, will carry out the IPO when the SEC has declared the IPO filings effective and when the DataCo board determines that market conditions are appropriate, but in no event later than 150 days after the shares are transferred to the banks.

Subject to normal corporate requirements and the investor safeguards described below, at any time after the IPO, DataCo will have the ability to issue additional Class A shares (for example, to fund acquisitions or major business initiatives), and it is expected that DataCo will do so. In the event that additional Class A shares are issued, the conversion of the Class B shares will give Bell Atlantic/GTE less than an 80% economic interest in DataCo. However, the shares into which the Class B shares are convertible will have enhanced voting provisions that are likely to preserve Bell Atlantic/GTE's voting control following conversion even if additional shares have been issued.

Bell Atlantic/GTE's conversion rights will only be exercisable within five years from the closing of the merger. If it has failed to receive sufficient interLATA relief to operate the business, Bell Atlantic/GTE will either sell its Class B stock (which includes the conversion rights) or exercise the conversion rights for the purpose of disposing of its interest in DataCo or any assets that are prohibited to Bell Atlantic/GTE under section 271 or otherwise bringing DataCo's business into compliance with applicable law. Bell Atlantic/GTE will have the right to sell all or part of its Class B shares at any time. To the extent Class B shares are purchased by someone who is not subject to the section 271 restrictions, that purchaser would be free to convert those Class B shares immediately.

Until Bell Atlantic/GTE exercises its option, DataCo will be independent of Bell Atlantic/GTE. DataCo will have an independent board of directors that is periodically elected by the voting shareholders consistent with the requirements of applicable corporation laws. The board will have 10 members. One member will be the CEO of DataCo and eight of the remaining nine directors will be outside directors who will have no affiliation with Bell Atlantic or GTE. At least five of the unaffiliated directors will be up for election within six months after completion of the IPO. The tenth director will be elected by a class vote of the Class B shares and will not be eligible to serve as chairman. The board and officers of DataCo will owe fiduciary duties to the public shareholders. Incentive compensation for DataCo's managers will be tied to the performance of DataCo and the value of DataCo's publicly traded stock, not to the financial performance or stock value of Bell Atlantic/GTE. The initial source of financing for DataCo will be the proceeds from the sale of Class A stock in the IPO. Any additional funding required by DataCo during the interim would be raised from the public markets, possibly by issuing additional Class A shares, or by arm's-length commercial loans from Bell Atlantic/GTE.

Bell Atlantic/GTE's interests as a minority investor and holder of an option to acquire a controlling interest in the future will be protected by certain reasonable investor safeguards that are both typical of the rights commonly held by option holders or other prospective acquirers and modeled on investor protections that have regularly been permitted by the Commission. These will include the right to approve certain fundamental business changes that adversely impact the value of Bell Atlantic/GTE's minority investment and conversion rights, including a change in control of DataCo or the sale of a significant portion of its assets. The investor safeguards we expect to include are listed in Schedule A, appended hereto.

The DataCo solution will fully preserve the integrity and competitiveness of GTE-I's existing business while also preserving Bell Atlantic/GTE's ability (contingent on interLATA relief) eventually to reacquire control of DataCo and bring to market the full range of long-term Internet and data benefits promised by the merger. In the meantime, this solution will enable customers to begin realizing immediately some of these important data benefits, since a significant portion of DataCo's business will be outside the Bell Atlantic region or in in-region states where Bell Atlantic has achieved 271 relief. Accordingly, during the period before the option is exercised, Bell Atlantic/GTE will market DataCo services (or the two companies will market their services jointly) as and where permitted by law. For example, in New York, where Bell Atlantic has already received 271 approval, Bell Atlantic/GTE and DataCo will jointly market DataCo's Internet connectivity services.

All commercial interactions between Bell Atlantic/GTE and DataCo will be conducted pursuant to commercially reasonable contracts. This is consistent with the fact that DataCo and Bell Atlantic/GTE will each be independent public corporations whose directors and officers will owe duties of care and loyalty to their respective shareholders. These contracts will encompass the marketing arrangements discussed above as well as certain administrative support services that DataCo may require from Bell Atlantic/GTE. Schedule B, appended hereto, describes in further detail the commercial contracts between Bell Atlantic/GTE and DataCo.

B. Until Bell Atlantic/GTE Attains InterLATA Relief and Exercises Its Option, DataCo Will Not Be an "Affiliate" Under Section 271.

Section 271(a) generally prohibits a Bell operating company, or "BOC," from providing interLATA telecommunications originating in an in-region state, whether directly or through an "affiliate," until the BOC has received authority to do so under section 271(b). 47 U.S.C. § 271(a). The controlling definition of "affiliate" set forth in section 3(1) of the Communications Act, 47 U.S.C. § 153(1), provides:

> The term "affiliate" means a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person. For purposes of this paragraph, the term "own" means to own an equity interest (or the equivalent thereof) of more than 10 percent.

Under the structure described above, Bell Atlantic/GTE will not own or control DataCo before attaining interLATA relief, and thus DataCo will not be an "affiliate" of Bell Atlantic/GTE's BOCs within the meaning of section 3(1).

1. Bell Atlantic/GTE Will Retain Only a 10% Equity Ownership Interest Pending InterLATA Relief and Thus Will Not "Own" DataCo.

Pending interLATA relief, Bell Atlantic/GTE's equity ownership interest in DataCo will not exceed the permissible 10% level, and thus Bell Atlantic/GTE will not "own" DataCo for purposes of the Communications Act.

Section 3(1) of the Act is concerned with "ownership" of "equity interests." The ownership of an equity interest in a corporation is represented by stock, and the primary indicia of equity ownership conferred by stock include voting control over the corporation's management and a right to participate in residual earnings through a distribution of dividends. *See* 11 Fletcher's Cyclopedia of the Law of Private Corporations § 5081 (perm. rev. ed 1995) (citing authorities); *Paulsen v. Commissioner*, 469 U.S. 131, 138 (1985) ("equity characteristics" of shares include "the right to vote on matters" and the right to "receive dividends . . . paid out of net earnings").

Here, the public shareholders of DataCo will hold 90% of the voting rights in DataCo and will be entitled to receive 90% of any dividends or other economic returns derived from DataCo during the period before Bell Atlantic/GTE exercises its option. Bell Atlantic/GTE will own only 10% of the voting rights and will be entitled to receive only 10% of any interim dividends paid by DataCo. Moreover, Bell Atlantic/GTE will not receive any tax benefits resulting from net operating losses incurred by DataCo during the interim and will receive no other current financial benefit or economic return from its limited stake in DataCo. Accordingly, before obtaining interLATA relief, Bell Atlantic/GTE will not "own an equity interest" in DataCo of more than 10% under the traditional indicia of equity ownership.[21]

The fact that Bell Atlantic/GTE will also hold an option to convert its 10% ownership interest into an 80% interest in the future, once it receives sufficient interLATA relief, does not mean that Bell Atlantic/GTE will own a greater than 10% equity interest in DataCo before the option is exercised. The traditional rule of property law is that "a mere option to purchase land does not vest the holder of an option with any interest, legal or equitable, in the land." *Todd v. Citizens' Gas Co.*, 46 F.2d 855, 866 (7th Cir. 1931). Thus, as the Commission itself has recognized, options, warrants and other convertible securities are nothing more than "potential future equity interests." *Biennial Review of Spectrum Aggregation Limits*, Report and Order, WT Docket No. 98-205, ¶ 8 (Sept. 22, 1999). *See In re Woods Communications Group*, 12 FCC

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[21] Similarly, Bell Atlantic/GTE will not own the "equivalent" of an equity interest above 10% within the meaning of section 3(1). The parenthetical phrase "(or the equivalent thereof)" in section 3(1) is reasonably read to encompass ownership interests that may not carry the voting rights or usual form of common stock but that still carry the traditional economic rights of equity ownership, including, most importantly, the right to receive a share of current profits. Such interests may include partnership shares or instruments nominally characterized as debt, such as promissory notes, that in fact entitle the holder to receive a pro-rata distribution of current profits, not simply an interest payment. *Cf., e.g., Fox Television Stations, Inc.*, 11 FCC Rcd 5714, ¶¶ 14-18 (1995) (foreign entity held to own more than 25% of capital stock of domestic broadcast licensee by virtue of promissory notes that entitled foreign entity to receive 99% of current profits). Because Bell Atlantic/GTE will be entitled to receive only 10% of current profits or other economic returns of DataCo pending interLATA relief, Bell Atlantic/GTE will not own the "equivalent" of an equity interest of more than 10%.

Rcd 14042, ¶¶ 13-14 (1997) (characterizing options as "future equity holdings" and "possible equity interests").

Consistent with the general legal rule, options and other rights to acquire *future* equity interests, such as the conversion rights Bell Atlantic/GTE will have, do not count as ownership interests in determining affiliate status under section 3(1). The plain terms of section 3(1) and all relevant precedents establish that only *current* equity interests count against the 10% limit. Section 3(1) is written in the present tense ("owns," "is owned," "is under common ownership"). The plain terms of the statute thus indicate that only *current* ownership interests, as opposed to *future* interests like options and other conversion rights, are to be taken into account in determining compliance with the 10% ownership ceiling.

This reading is borne out by Commission precedent applying section 3(1). In *In re Time Warner Cable*, 12 FCC Rcd 23363 (1997), the Cable Bureau ruled that Bell Atlantic did not "own an equity interest (or the equivalent thereof) of more than 10 percent" in CAI Wireless, a multichannel video programming distributor, even though Bell Atlantic owned "7,000 shares of CAI Senior Preferred Stock, which are unilaterally convertible into shares of CAI Voting Preferred Stock, which are then unilaterally convertible into shares of CAI Common Stock." *Id.* § 4. Although Bell Atlantic had the right to convert its preferred shares into voting shares at will, which would give it a greater than 10% ownership interest in CAI, the Cable Bureau nevertheless agreed that "debt and instruments such as warrants, convertible debentures, options or other non-voting interests with rights of conversion to voting interests" do not count as equity interests "unless and until conversion is effected." *Id.* § 8 (quotation marks omitted).[22]

In all other contexts where (as with section 271) the Commission enforces ownership attribution limits in order to safeguard competition, the Commission has consistently ruled that options and other convertible interests do not count as ownership:

- In its broadcasting and cable attribution rules, the Commission has concluded that call options and convertible rights are not cognizable ownership interests. *E.g., Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, MM Docket No. 94-150, at ¶ 2 n.4 (1999) ("The following corporate interests are not currently attributable: minority stockholdings in corporations with a single majority shareholder; nonvoting stock; other nonvoting instruments such as options or warrants; and debt."); *Attribution of Ownership Interest*, 97 F.C.C. 2d 997 (1984) (adopting 47 C.F.R. § 73.3555) ("Holders of debt and instruments such as warrants, convertible debentures, options or other non-voting interests with rights of conversion to voting interests shall not be attributed unless and until conversion is effected."); *In re Implementation of 1992 Cable Act*, CS Docket No. 98-82, at ¶ 129 n.329 (1999) ("We disagree . . . that options, warrants, and convertible debentures should generally be treated as beneficial interests under our rules creating an attribution . . . . We do not believe that these types of securities demonstrate . . . current, active participation.") The Commission adopted these attribution rules to ensure that competition is not impaired through undue concentration of ownership. Specifically, the cable attribution rules, like section 271's limitations on affiliated ownership, "are designed to promote competition by ascertaining the minimum interest necessary for one entity to potentially influence another." *Id.* ¶ 128. Nevertheless, the Commission concluded that options, convertible rights and other such future interests "exist outside the concerns and constraints of the multiple ownership rules." 97 F.C.C. 2d 997, at ¶ 48.

- In applying the CMRS spectrum aggregation cap, the Commission has concluded that "securities affording potential future equity interests," such as options, warrants and conversion rights, are not deemed attributable until exercised. 47 C.F.R. § 20.6(d)(5); *see also 1998 Biennial Regulatory Review, Spectrum Aggregation Limits for Wireless Telecommunications Carriers*, WT Docket No.

[22] Whatever its precise meaning, the phrase "(or the equivalent thereof)" in section 3(1) certainly does not expand the plain terms of the statute to encompass potential future equity interests. This phrase must be interpreted in a way that preserves the substantive distinction between current and future equity ownership.

98-205, ¶ 8 (1999). The CMRS spectrum cap rules, just like section 271, are intended to promote competition and ensure that large wireless carriers do not "exclude efficient competitors, . . . reduce the quantity or quality of services provided, or . . . increase prices to the detriment of consumers." *Id.* § 9.

- Under the LEC/LMDS cross-ownership prohibition, "[d]ebt and interests such as warrants and convertible debentures, options, or other interests (except non-voting stock) with rights of conversion to voting interests shall not constitute attributable interests unless and until conversion is effected." *Local Multipoint Distribution Service and Fixed Satellite Services,* 12 FCC Rcd 12545 (1997) (adopting 47 C.F.R. § 101.1003(e)(5)). This cross-ownership provision prohibits incumbent LECs, including BOCs, from owning an LMDS license in-franchise. The purpose of the restriction, again, as with section 271, is to ensure that incumbent LECs do not accumulate ownership interests that might allow them to exclude or handicap competitors. *Id.* ¶ 159.[23]

The same approach applies to statutory ownership prohibitions, as distinct from Commission-created attribution rules that are subject to waiver. In 47 U.S.C. § 310(b)(4), for example, Congress prohibited the Commission from granting a license to any corporation directly or indirectly controlled by an entity "of which more than one-fourth of the capital stock is owned of record or voted by aliens." In enforcing this statutory ban, the Commission has concluded that "future interests, such as options and convertible rights, are not relevant to our

[23] Both the spectrum cap and LMDS attribution rules allowing convertible securities contain a parenthetical exception for "non-voting stock." *See* 47 C.F.R. §§ 20.6(d)(5) ("(except non-voting stock)"), 101.1003(e)(5) (same). This exception does not mean that the Commission considers a convertible interest in stock to be fully attributable before the conversion rights are exercised. Rather, it simply means that current ownership of stock *in excess of the relevant equity threshold* will be attributable, whether or not the stock carries voting rights. This meaning is made clear by the history of these rules, which were both based on attribution rules developed in the PCS context. *See Amendment of the Commission's Rules to Establish New Personal Communications Services*, 9 FCC Rcd 4957 (1994). There, the Commission decided that non-voting stock exceeding the relevant equity threshold would be attributable, and, in discussing convertible interests, stated that "consistent with other multiple- and cross-ownership attribution standard[s], convertible debt instruments or options *with rights of conversion to equity interests* shall not be attributed unless and until conversion is effected." *Id.* ¶ 119 (emphasis added). Thus, the relevant issue for attribution purposes is the extent of the current economic interest represented by the equity held, not the extent of its convertibility.

alien ownership determinations until converted." *BBC License Subsidiary*, 10 FCC Rcd 10968, ¶ 20 n.12 (1995); *see also In re GWI PCS, Inc.*, 12 FCC Rcd 6441, ¶ 10 (1997) ("Future interests are also not factored into Section 310(b) determinations."). The Commission has adhered to this approach even in cases where the foreign entity holds an option "to reacquire . . . stock in a licensee or the parent of a licensee," since the Commission recognizes that such an option does not constitute an ownership interest "until it is exercised." *In re DCR PCS, Inc.*, 11 FCC Rcd 16849, ¶ 24 (1996).

It makes no difference to this analysis that Bell Atlantic/GTE may exercise its option without any additional payment. Consideration for the option will be given up front through Bell Atlantic/GTE's contribution of its interests in GTE-I to DataCo. Regardless of an option's exercise price, for attribution purposes, the Commission has ruled that there is "[n]o presumption that an option will be exercised." *WWOR-TV, Inc.*, 6 FCC Rcd 6569, n.13 (1991). Thus, for example, in *In re Richard R. Zaragoza*, 14 FCC Rcd 1732 (1998), the Mass Media Bureau, applying the Commission's newspaper/broadcasting cross-ownership rules, permitted a newspaper publisher to hold an option to purchase a 49% interest in the parent company of a prohibited television station notwithstanding the fact that the publisher paid $53,800 for the option up front and could exercise the option at any time for a token payment of $100. The Bureau concluded that such "purchase options and other potential future rights are noncognizable for current attribution purposes," regardless of whether any additional payment is required to exercise the option rights. *Id.* at 1737. The Bureau reasoned that the "up-front" nature of the option payment did not warrant a deviation from our normal policy regarding attribution of options" because "[t]he payment does not change the fact that the option may not be exercised."

Id. Here, too, there is a possibility that Bell Atlantic/GTE may choose not to exercise its option for economic or business reasons. Moreover, Bell Atlantic/GTE may not receive the interLATA relief required to own and operate DataCo. If it does not receive sufficient interLATA relief to operate the business, Bell Atlantic/GTE will either have to sell its convertible interest in DataCo or exercise the option and take steps to ensure that its ownership of DataCo complies with the law.[24]

A significant body of relevant legal precedent under the Modification of Final Judgment, or "MFJ," the direct legal antecedent to section 271, also confirms that Bell Atlantic/GTE's option will not amount to ownership and will not make DataCo an affiliate. Judge Greene and the Department of Justice repeatedly approved the BOCs' holding options and other conditional interests in prohibited businesses, and these conditional interests were specifically approved as a way to allow the BOCs to preserve particular business opportunities while seeking the necessary waiver of MFJ prohibitions. *See United States v. Western Elec. Co.*, No. 82-0192 (D.D.C. Aug. 7, 1986) ("Conditional Interest Order") (setting forth standards for approval of

[24] The only situation in which the Commission has treated options as attributable interests is in the spectrum auction context. *See, e.g.*, 47 C.F.R. § 1.2110(b)(2); *id.* § 22.223(d)(5) (Public Mobile Services); *id.* § 24.709(a)(7) (C and F Block Licenses); *id.* § 95.816 (218-219 MHz Service); *id.* § 101.1112 (LMDS); *id.* § 101.1209 (38.6-40.0 GHz Band). That context is very different from section 271 or other contexts where the focus is on protecting competition. In the spectrum auction context, concerns about the *long-term* structure of the industry are paramount -- for example, the auction rules are designed to foster the development of greater diversity among license holders. Where the focus is on long-term industry structure, contingent or future ownership interests will be taken into account. Where competition is the concern, on the other hand, eliminating *current* ownership and control is sufficient, and contingent future interests like options are permitted. Thus, for example, the federal Clayton Act, which governs the antitrust analysis of mergers, *does not* regulate the purchase of an option or other convertible interest, only the "subsequent conversions of convertible voting securities." *See* 16 C.F.R. § 802.31 (Hart-Scott-Rodino reporting regulations).

conditional interests);[25] Report of the United States Concerning Proposed Purchase by NYNEX Corp. of a Conditional Interest in Tel-Optik, Ltd. at 8 (June 20, 1986) ("DOJ Tel-Optik Report") ("we agree" that a BOC may acquire a contingent interest "to preserve the right to purchase the [prohibited] stock upon FCC approval and grant of a waiver application by the Court").[26]

The conditional interests approved under the MFJ typically involved the right to exercise an option (or convert debt to equity) where the price of the option or conversion rights was established, or even paid, in advance. *See, e.g.*, DOJ Tel-Optik Report at 5-6 (NYNEX would acquire a 50% interest in an interLATA cable system by repaying a 50% share of the actual construction debt to be incurred); Letter from Kenneth E. Millard to Barry Grossman, DOJ, at 3 (Sept. 16, 1986), attached to Report of the United States to the Court Concerning Procedures for Approval of Conditional Interests and Ameritech's Acquisition of a Conditional Interest in Corporation X (Sept. 19, 1986) ("Millard Letter") (funds invested up front for research and development were convertible into a fixed amount of stock defined as "the same number of shares of preferred stock . . . as the total of the development funds expended . . . up to $2.5 million would purchase in a pending preferred equity round of financing"); Letter from Thomas P. Hester to Nancy C. Garrison, DOJ, at 2-3 (July 7, 1987), attached to Report of the United States to the Court Concerning Ameritech's Acquisition of a Contingent Interest (July 15, 1987)

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[25] Judge Greene's Conditional Interest Order was reversed on procedural grounds not relevant here. *See United States v. Western Elec. Co.*, 894 F.2d 430 (D.C. Cir. 1990). Nevertheless, the order spawned a body of precedent concerning options and other conditional interests that is directly relevant.

("Hester Letter") (initial option price was $5 million plus potential additional payments of up to $10 million; no additional payment was required to exercise the option).

These MFJ-approved options could be sold to a third party if the BOC failed to obtain a waiver. In 1986, the Justice Department reviewed and approved an option to acquire an interest in a prohibited business that Ameritech was permitted to sell to a third party after seven years. Ameritech "would retain all proceeds from such a sale up to $3 million and would share any proceeds in excess of $3 million on a 50-50 basis." Millard Letter at 4. Likewise, in 1987, DOJ reviewed and approved a second Ameritech option that was transferable after three years and allowed Ameritech to keep all proceeds from the transfer, including any appreciation in value reflected in those proceeds. Ameritech was specifically allowed to keep such proceeds even in the event it failed to obtain the necessary MFJ waiver. Hester Letter at 3.

Several interested parties sought review of Ameritech's 1986 option because it was "transferable, and Ameritech would be free to sell its option to a third party without approval of the Court." Motion of IDCMA to Establish Briefing Schedule at 4 (filed Oct. 2, 1986) (footnotes omitted). The Justice Department opposed this challenge, *see* Opposition of the United States to Motion of IDCMA to Establish Briefing Schedule (filed Oct. 21, 1986), and Judge Greene permitted Ameritech to acquire the option.

Similarly, MCI challenged Ameritech's 1987 option on the ground that because "Ameritech proposes to acquire *transferable* options," it would have an "immediate equity

[26] In key respects, the MFJ prohibitions were stricter than section 271. The MFJ did not allow any *de minimis* ownership interest, in contrast to the 10% equity interest permitted under the statute. The 1996 Act also repealed the MFJ's prohibitions on interLATA wireless services, certain interLATA information services, royalty arrangements with manufacturers, and the selection of interLATA carriers for payphones.

interest," not merely a conditional interest. MCI's Protest to Justice's Report on Ameritech's Acquisition of a "Conditional" Interest in an Information Services Provider at 1 (filed July 30, 1987) (emphasis in original). Ameritech responded that it was "simply attempting to preserve an important business opportunity until it can get a waiver to engage in the new business. . . . If, after three years, it becomes apparent that Ameritech cannot obtain Court approval to exercise the option . . . , Ameritech should be permitted to liquidate its contingent position. Competition is not endangered because Ameritech may wish to *give up* its ability to enter the market." Ameritech's Response to MCI Protest at 1-2, 4 (filed Aug. 13, 1987) (emphasis in original). Judge Greene refused to grant MCI's protest, and Ameritech was allowed to acquire the option.

Finally, the Justice Department approved at least one transaction, analogous to the option proposed here, where a BOC restructured a pre-existing ownership interest in a prohibited business into a conditional interest as a means of ending the violation. In May 1987, SBC bought a 21.5% voting interest in a company that engaged in research and development of specialized telephone equipment. In December 1987, Judge Greene ruled that such activities were prohibited by the MFJ's manufacturing ban. SBC sought to restructure its current equity ownership into convertible warrants that could be exercised "at a nominal price." Affidavit of Robert A. Dickemper ¶ 5 (Apr. 4, 1988), attached to Report of the United States Concerning the Proposed Retention of a Conditional Interest by Southwestern Bell Corp. (filed Apr. 15, 1988). The Justice Department approved SBC's holding the conversion rights represented by the warrants while it sought a waiver to own the prohibited business, and Judge Greene allowed the restructuring.

In sum, all relevant federal precedents, including prior Commission orders and rules, make it clear as a matter of law that under the proposed structure, Bell Atlantic/GTE will not own more than the permissible 10% of DataCo for purposes of section 271 unless and until Bell Atlantic/GTE exercises its option.

2. Bell Atlantic/GTE Will Not Control DataCo Pending InterLATA Relief.

Bell Atlantic/GTE will also not control DataCo before exercise of the option. Section 3(1) of the Communications Act does not set forth a standard for determining control, but under the Commission's precedents, control is generally a factual question that turns on multiple factors or the totality of circumstances. *See, e.g.*, *Stereo Broadcasters, Inc.*, 55 F.C.C.2d 819, 821 (1975), *modified*, 59 F.C.C.2d 1002 (1976) ("The ascertainment of control in most instances must of necessity transcend formulas, for it involves an issue of fact which must be resolved by the special circumstances presented."). Analyzing the standard factors typically considered by the Commission, it is plain that the public shareholders and not Bell Atlantic/GTE will control DataCo.

Most importantly, actual control will rest with the public shareholders who will hold 90% of the voting control of DataCo. Under our proposal, it is the public shareholders, not Bell Atlantic/GTE, who will control the election of all but one member of DataCo's board. Both the officers and directors of DataCo will owe fiduciary duties of loyalty and care to the public shareholders. And the public shareholders, not Bell Atlantic/GTE, will control the outcome of other decisions that are subject to general shareholder approval.

Nor will Bell Atlantic/GTE retain *de facto* control over DataCo. As the Commission has often reaffirmed, the "determinative question" in an analysis of *de facto* control is whether a party can "dominate the management of corporate affairs." *Trinity Broadcasting of Florida, Inc.*, 15 Comm. Reg. (P & F) 757 (1999); *see also Fox Television Stations, Inc.*, 10 FCC Rcd 8452, 8514 (1995) (quoting *Benjamin L. Dubb*, 16 F.C.C. 274, 289 (1951)). Here, it is absolutely clear that Bell Atlantic/GTE cannot dominate the management of DataCo's affairs while it owns only 10%. DataCo will be operated and managed independently from Bell Atlantic/GTE, and Bell Atlantic/GTE will have no control over the day-to-day management and operation of its business.

Other relevant factors in the *de facto* control analysis include whether the allegedly controlling party receives monies and profits derived from the operation of the facilities; whether that party is in charge of the payment of financing obligations, including operating expenses; and whether it has unfettered use of all facilities and equipment. *See, e.g.*, *Intermountain Microwave*, 24 Rad. Reg. (P & F) 983, 984 (1963). These additional factors further confirm that the investing public and not Bell Atlantic/GTE will control DataCo. First, Bell Atlantic/GTE will not derive more than a 10% share of the profits or other economic returns of DataCo's business before the option is exercised. Second, DataCo (not Bell Atlantic/GTE) will be responsible for its own financing. If DataCo wishes to obtain financing from Bell Atlantic/GTE, it will do so through arm's-length commercial loans. Finally, DataCo's management and board of directors will control the use of all facilities and equipment of DataCo.

This conclusion is not affected by the investor protections relating to fundamental business changes that will safeguard Bell Atlantic/GTE's rights as an option holder and minority investor. (These are listed in Schedule A.) Such provisions are ordinary and reasonable investor safeguards and are precisely the kinds of protections that any option holder or other prospective acquirer would have with an executory purchase agreement. Indeed, Bell Atlantic/GTE could reasonably obtain such purchaser safeguards if DataCo were *already* an independent public corporation and Bell Atlantic/GTE entered into an executory contract today to acquire 80% of DataCo after receiving interLATA relief.

Numerous Commission rulings clearly establish that precisely the sorts of investor safeguards involved here do not constitute control. As the Commission has repeatedly ruled, provisions such as these "fall within the scope of accepted purchaser safeguards that the Commission has previously found not to constitute a premature [license] transfer." *In re Applications of Puerto Rico Telephone Auth., Transferor, and GTE Holdings (Puerto Rico) LLC, Transferee*, 14 FCC Rcd 3122, ¶ 44 (1999). In its *Puerto Rico Telephone* order, the Commission specifically approved "limitations on the target compan[y's] entering into new lines of business, making substantial and material alterations to current contracts or agreements, disposing of material assets, and making substantial outlays of capital." *Id.* (citing specific license transfer precedents approving such protections).

The Commission has also consistently ruled that reasonable investor protections do not confer control for purposes of the Commission's attribution rules. For example, in *In re Applications of Roy H. Speer, Transferor, and Silver Management Co., Transferee,* 11 FCC Rcd 14147 (1996), the Commission ruled that a third party who held certain contractual veto rights over fundamental business changes did not have an attributable interest in a corporation. Similarly, in *Applications of Quincy D. Jones, Transferor, and Qwest Broadcasting, LLC, Transferee,* 11 FCC Rcd 2481 (1995), the Commission allowed a party who was prohibited from exercising control over a corporation nevertheless to hold supermajority voting rights concerning certain fundamental corporate decisions. The Commission explained that "[t]he right to participate in matters involving extraordinary corporate actions . . . does not ordinarily undermine the nonattributable character of otherwise noncognizable interests, so long as the voting rights or licensee obligations are narrowly circumscribed." *Id.* ¶ 29.

In cases such as these, the Commission has specifically approved veto or supermajority voting rights over business changes including: the sale or acquisition of significant assets outside the ordinary course; any merger or consolidation; the assumption of significant new debt; material changes to the corporate charter or by-laws; the payment of dividends in excess of profits; the issuance of new securities; the formation of new subsidiaries; entering into new lines of business; and significant transactions with other shareholders or interested parties.[27] These

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[27] The specific veto rights approved in *Roy H. Speer* included vetos over: "any 'Fundamental Matter,' defined . . . to include the following actions: (1) any transaction not in the ordinary course of business . . . ; (2) the acquisition or disposition 'of any assets' or business with a value of 10 percent or more of the market value of [the total business]; (3) the incurrence of any indebtedness, which in a single transaction or in the aggregate has a value of ten percent or more of [the total business]; (4) any material amendments to the certificate of incorporation or bylaws . . .; (5) engaging in any line of business other than media, communications and entertainment products, services and programming; (6) the settlement of any litigation, arbitration or other proceeding which is other than in the ordinary course of business and which involves any material restriction on the conduct of business . . . ; and (7) any transaction between [the company and its majority owner], subject to exceptions relating to the size of the proposed transaction and those transactions which are otherwise on an arm's length basis." 11 FCC Rcd 14147, at ¶ 18.

In *Quincy D. Jones*, the Commission specifically permitted supermajority approval rights over the following corporate decisions: "(1) the sale or other disposition of any material portion of the LLC assets, other than in the ordinary course; (2) any merger or consolidation involving the LLC; (3) any voluntary liquidation, dissolution or termination of the LLC; (4) the declaration or payment of any distributions; (5) the issuance of any additional LLC shares or incurrence of debt in excess of $250,000 individually or $1 million in the aggregate; (6) any initial registered public offering of any LLC equity interests; (7) any change of Qwest's name or any amendment of the certificate of formation or the LLC agreement which adversely affect the rights of any LLC member; (8) the entry by the LLC into any agreement with a shareholder; (9) the creation are the same sorts of investor safeguards that will protect Bell Atlantic/GTE's interests in DataCo. *See* Schedule A.[28]

Nor will the marketing arrangements and various other commercial contracts between the two companies (detailed in Schedule B) give Bell Atlantic/GTE *de facto* control over DataCo's management. These contracts will be commercially reasonable in all respects and, with respect to administrative support services, will be limited in scope to specific administrative functions. Moreover, the fact that both companies will be public corporations with independent obligations to their shareholders will help ensure that all interactions between them will be commercially reasonable. The contracts involved here certainly will not enable Bell Atlantic/GTE to "dominate the management of corporate affairs" or decision-making of DataCo for purposes of the Commission's standard *de facto* control analysis. *See In re Lockheed Martin Corp.*, FCC 99-237, 1999 WL 717252, at ¶ 32 (1999).

Indeed, the administrative services contracts between Bell Atlantic/GTE and DataCo will be far *less* involved than typical transitional arrangements approved in other divestitures. Judge Greene, for example, in the Bell System breakup, approved the sharing of network facilities between AT&T and the Bell companies for up to eight years. *United States v. Western Elec. Co.*, 569 F. Supp. 1057, 1098 n.181 (D.D.C.), *aff'd sub nom. California v. United States*, 464 U.S. 1013 (1983). Although the MFJ strictly prohibited the Bell companies from offering interLATA services and required the Bell companies and AT&T to become independent as of the divestiture,

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of any subsidiary of the LLC; and (10) any acquisition or any agreement to acquire any entity." 11 FCC Rcd 2481, ¶ 9.

[28] Similar investor safeguards were repeatedly permitted to BOCs in connection with conditional interests in prohibited businesses under the MFJ.

the Bell companies were permitted for five and a half years after divestiture to "write inter-LATA orders for AT&T under a sharing contract" (provided they made such services available to other carriers as well); to "provide circuit provisioning functions for AT&T"; and to provide installation and maintenance services for AT&T's interLATA "special services." 569 F. Supp. at 1096 n.172. Other functions were allowed for even longer periods. *Id.* ("AT&T operators [were allowed to provide] inter-LATA Call Completion and Assistance services" for the Bell companies for up to 10-1/2 years after divestiture); 569 F. Supp. at 1098 n.181 (Bell companies were permitted to lease AT&T interLATA facilities for internal use for eight years). In each instance, Judge Greene found that the proposed sharing of facilities or personnel did not involve the Bell companies impermissibly in providing interLATA services and did not give AT&T "control over the [Bell companies' local exchange] functions." MFJ § I(A)(2).

In general, antitrust divestiture decrees whose purpose is to ensure independence of two competing businesses routinely permit and even *require* transitional services of various types. For example, in the pending antitrust decree involving Bell Atlantic's, GTE's, and Vodafone AirTouch's wireless businesses, the divesting companies are required to offer any purchaser of the divested wireless properties the ability "for a reasonable period at the election of the purchaser to use any of the divesting defendant's assets used in the operation of the wireless business being divested." Proposed Final Judgment § II.G, *United States v. Bell Atlantic Corp.*, Civil No. 1:99CV01119 (D.D.C. filed Dec. 6, 1999). The assets and services that may be provided include network assets and also "operational support systems, customer support and billing systems, interfaces with other service providers, . . . patents, . . . trademarks, . . . or other intellectual property." *Id.*

C. The DataCo Solution Is Fully Consistent With the Policies Behind Section 271.

The above discussion is sufficient to establish that under the applicable legal standards, DataCo will not be an "affiliate" of Bell Atlantic/GTE under sections 271 and 3(1) of the Act. Accordingly, the DataCo structure we have proposed will completely resolve the only legal issue raised under section 271. Beyond satisfying the strict letter of the law, this solution is also fully consistent with the underlying policies of section 271.

The DataCo solution will preserve and even enhance Bell Atlantic/GTE's incentives to comply fully and expeditiously with the 271 checklist requirements. Bell Atlantic/GTE will retain the same baseline incentive that all BOCs have to comply with 271 in order to gain in-region entry into the lucrative market for traditional voice long distance service. Furthermore, the five-year limitation on the exercise of Bell Atlantic/GTE's option, and the accompanying risk that Bell Atlantic/GTE will lose its ability to get GTE's valuable data business back, will create a powerful additional incentive for Bell Atlantic/GTE to complete the 271 process as quickly as possible in its remaining in-region states.

As Bell Atlantic/GTE moves forward with the 271 process, moreover, there is no significant risk that Bell Atlantic/GTE's BOCs will engage in discrimination in favor of DataCo. First, the nature of the Internet and related data businesses involved here ensures that, as a practical matter, there is little likelihood of discrimination. Presently, GTE Internetworking is not significantly dependent upon access to LEC local loops, switching, central office space or other core LEC facilities; its purchase of traditional local loops is limited to the provision of wholesale DSL service to ISPs, a business that currently accounts for less than 1% of GTE-I's revenues. The primary inputs GTE-I purchases from BOCs and other LECs are point-to-point circuits, principally DS-1s and DS-3s. In many locations, including the larger metropolitan areas where many of GTE-I's business customers are located, such circuits are available from multiple providers on a competitive basis.

Second, in those areas where a Bell Atlantic BOC is the only available provider of point-to-point circuits for DataCo, the risk of discrimination will be readily addressable. DataCo will purchase all such circuits on a tariffed basis, which will ensure that DataCo is not advantaged by discriminatory pricing. And any effort by Bell Atlantic/GTE to advantage DataCo in the timing or quality of provisioning of these circuits would be easily policeable by the Commission and competitors of DataCo.

Third, what is most important to consider is the impact on Bell Atlantic/GTE's *net* incentives, and the DataCo solution ensures that the incentive to comply with 271 will remain dominant. Bell Atlantic/GTE would have very little to gain and everything to lose if it acted anticompetitively to advantage DataCo. Discriminatory behavior by Bell Atlantic/GTE could confer only a small and highly contingent benefit. On the other hand, far outweighing that remote benefit is the fact that Bell Atlantic/GTE would run an enormous risk if it pursued a concerted effort to discriminate in favor of DataCo. Any hint of such discrimination would surely be trumpeted by opponents of 271 authority and could complicate or delay future 271 approvals, thus threatening Bell Atlantic/GTE's ability to exercise its option to retrieve ownership and control of DataCo. Evidence of such discrimination would likely also be used by such opponents as a basis to seek penalties from the Commission against Bell Atlantic/GTE, perhaps even including urging the Commission to impose the ultimate penalty -- rescission of

271 approvals previously granted. It would be irrational for Bell Atlantic/GTE to run any such risks.[29]

Beyond the issue of discrimination, the option structure here, which will separate GTE-I from Bell Atlantic/GTE until Bell Atlantic/GTE has received interLATA relief, is particularly well-suited to the fundamental design and objectives of section 271. The 271 interLATA restriction is temporary in nature; it is designed to fall away once Bell Atlantic/GTE satisfies the checklist requirements in the Bell Atlantic states. This restriction is very different from a prohibition, such as a horizontal cross-ownership prohibition, that is designed to be permanent or incapable of being fixed. Thus, in terms of the underlying statutory policies at issue, an option is even more appropriate here than in other regulatory or statutory contexts where similar arrangements have already been approved by the Commission.

Finally, the proposed arrangement will not automatically be applicable to other transactions or other contexts. This proposal is put forward in the context of a merger that involves primarily non-interLATA businesses. GTE Internetworking currently accounts for less

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[29] Once again, MFJ precedents are relevant on this point, because the risk of discrimination was a factor considered by Judge Greene in approving similar conditional interests. *See* Conditional Interest Order at 5, 7. Under the MFJ, the Justice Department recognized that it "might be argued" that the "anticipation of a future interest" created by an option "may increase [the BOC's] incentive to discriminate against existing or potential competitors in providing access to the local exchange during the interim period." DOJ Tel-Optik Report at 12 n.10. Nevertheless, the Department concluded that "[s]uch behavior . . . is unlikely to occur in view of the fact that the Department and interested parties will be reviewing [the BOC's] waiver application during the very period when any such discriminatory activity would occur." *Id.* Judge Greene agreed, concluding that where the conditional interest could not be exercised without the granting of a waiver, "the legal obstacles to anticompetitive conduct are decisive." Conditional Interest Order at 7. Likewise, here, the availability of the 271 review process and the substantial risk that anticompetitive conduct by Bell Atlantic/GTE would jeopardize its ability to achieve or retain 271 approvals should thoroughly dispel any concerns about discrimination.

than 2% of Bell Atlantic/GTE's combined revenues. Furthermore, the arrangement we propose is narrowly tailored to address the unique factual circumstances and competitive interests raised by GTE-I's role as an Internet backbone provider. Preserving Bell Atlantic/GTE's ability ultimately to take back ownership and control of GTE-I will enable GTE-I to remain the only independent, non-IXC-owned top-tier Internet backbone, which, in turn, will help protect the fragile state of equilibrium among peering backbones that is critical to healthy competition throughout the Internet.

The eventual re-integration of a strong and independent GTE-I with the merged Bell Atlantic/GTE will enable competition to flourish for a full range of products and services in all major markets from coast to coast. In other words, not only will the specific solution we propose for GTE-I further the particular policies of section 271, but this merger *with this solution*, taken as a whole, will optimize competition across all markets and is therefore strongly in the public interest.

V. CONCLUSION

For the foregoing reasons, Bell Atlantic and GTE respectfully request that the Commission promptly grant the license transfer applications required to complete their merger.

Respectfully submitted,

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I hereby certify that on this 27th day of January 2000, I served copies of the foregoing Supplemental Filing of Bell Atlantic and GTE and the separately bound Proposed Conditions for Bell Atlantic/GTE Merger either by hand or by mail, first-class postage prepaid, on the following:

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